



**Majlis Peguam
Bar Council Malaysia**

www.malaysianbar.org.my

15 Leboh Pasar Besar
50050 Kuala Lumpur, Malaysia
Tel : +603-2050 2050
Fax : +603-2026 1313, 2034 2825, 2072 5818
Email : council@malaysianbar.org.my

**Circular No 058/2018
Dated 1 Mar 2018**

To Members of the Malaysian Bar

**Tax Treatment of Insurance Proceeds and Compensation |
Inland Revenue Board Public Ruling No 8/2017 on Professional Indemnity Insurance**

We refer to the [Bar Council General Statement](#) dated 4 July 2011 entitled “General Information on Matters Discussed at the 4th BC Meeting Held on 18 June 2011”, and [Circular No 137/2013](#) dated 18 June 2013 entitled “Inland Revenue Board Public Ruling on Professional Indemnity Insurance (“PR 3/2009”) — Tax Treatment of Insurance Proceeds and Compensation”.

The Director General of Inland Revenue (“DGIR”) had taken the position that insurance proceeds and compensation paid to a claimant under a Professional Indemnity Insurance (“PII”) policy would be taxable as income received by the Member of the Bar against whom the claim has been made.

As Members may be aware, a test case was commenced by the Malaysian Bar in 2011. This case took some time to progress, due to various procedural issues raised by the DGIR. After much discussion with the DGIR and overcoming those issues, the test case was eventually resolved under section 102 of the Income Tax Act 1967, with the execution and recording of a settlement agreement dated 27 Nov 2017.

The terms of the settlement agreement are favourable to Members. Following the amicable resolution of the test case, the DGIR replaced his Public Ruling No 3/2009 with Public Ruling No 8/2017 on Professional Indemnity Insurance (“PII”), dated 19 Dec 2017, to reflect the agreed terms and principles.

A copy of Public Ruling No 8/2017 is attached for your reference.

Please note section 8 of Public Ruling No 8/2017, which provides as follows:

8. Tax Treatment on Insurance Proceeds and Compensation

- 8.1 Where a professional has been allowed a deduction for the PII premium paid, any proceeds received in connection with the PII will be subject to tax. The proceeds are taxed under subsection 22(2) of the ITA.
- 8.2 Compensation to a claimant can be made in the following manner –
 - (i) the insurance company pays the proceeds to the professional and the professional pays that amount to the claimant; or



(ii) the insurance company pays directly to the claimant.

The compensation paid in both of the above manner [*sic*] is allowed a deduction under subsection 33(1) of the ITA as it is incurred in the ordinary course of the business of a professional who is constantly exposed to the risk of being sued by his clients for negligence, error or breach of duty.

Example 10

Mohd Fahrin is an architect who practises his profession in the architectural consulting firm, Arkitek Asyraf & Goh (AAG). AAG purchased a PII policy for him to cover himself against the risk of being sued. In the year 2017, a dissatisfied client sued AAG for damages to the bungalow caused by faulty design by Mohd Fahrin. The insurance company concerned made a payment of RM200,000 to AAG and AAG then paid the amount as compensation to his client (the claimant).

The proceeds received by AAG totalling RM200,000 will be subject to tax, whilst the amount paid as compensation to the claimant is allowed as a deduction under subsection 33(1) of the ITA against the gross income of the AAG's business.

Example 11

Same facts as in **Example 10** except that the insurance company made the compensation payment of RM200,000 directly to the claimant.

The compensation amounting to RM200,000 paid directly to the claimant is deemed received in the books of the architectural firm and is subject to tax. The amount of proceeds paid as compensation to the claimant is deemed paid out from the firm's accounts and is allowable as a deduction under subsection 33(1) of the ITA against the gross income of the AAG's business.

- 8.3 A professional will bear the shortfall of compensation if the amount of compensation claimed by the claimant exceeds the amount of proceeds received from the insurer. The amount of shortfall is allowed as a tax deduction under subsection 33(1) of the ITA.

Example 12

Bernard, the sole-proprietor of a legal firm received proceeds amounting to RM200,000 from an insurance company and this amount could not cover the compensation of RM250,000 to be paid to a customer who had made a claim against him. Therefore, Bernard had to bear on his own RM50,000 to cover the shortfall of compensation payment to the claimant.

Proceeds amounting to RM200,000 will be subject to tax. When the proceeds are paid out as compensation to his client, the amount is allowed as a tax deduction. The compensation totalling RM50,000 incurred by Bernard is also allowable as a deduction from the gross income of his business.

While the DGIR seems to be under the misapprehension that insurance payouts on PII policies are customarily routed through the very law firms or professionals against whom claims have been made, this should not affect the substance of Public Ruling No 8/2017, which is now more favourable to Members of the Bar and other professionals.

Thank you.

Anand Raj
Chairperson

Tax Subcommittee of the Corporate and Commercial Law Committee



INLAND REVENUE BOARD MALAYSIA

**PROFESSIONAL INDEMNITY
INSURANCE**

PUBLIC RULING NO. 8/2017

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PROFESSIONAL INDEMNITY INSURANCE

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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**

1. Objective

The objective of this Public Ruling (PR) is to explain –

- (i) the deductibility of premium paid for a professional indemnity insurance (PII) policy; and
- (ii) the tax treatment on insurance proceeds received and compensation paid in relation to a PII policy.

2. Relevant Provisions of the Law

- 2.1 This PR takes into account laws which are in force as at the date this PR is published.
- 2.2 The provisions of the Income Tax Act 1967 (ITA) relevant to this PR are sections 22 and subsection 33(1).

3. Interpretation

The words used in this PR have the following meanings:

- 3.1 "Person" includes a company, a body of persons, a limited liability partnership and a corporation sole.
- 3.2 "Profession" includes the profession of lawyers, accountants, architects, doctors, pharmacists, engineers, surveyors or any other profession where the status of the profession is recognised by a written law or statute in Malaysia.
- 3.3 "Professional" means a person who belongs to a profession and is a member of a professional body or registered with a body which governs the profession.

4. Introduction

PII is an insurance policy for a professional which will protect him from liability or the risk of being sued for alleged negligence, error or breach of duty when practising his profession or carrying on his business. The insurance may cover the cost of defending the suit and the cost of compensation.

5. Prerequisite for a Professional to Carry On or to Practise a Profession

- 5.1 Certain professions require a person to be a member of the professional body which represents the profession to enable the person to practise and maintain his profession. Examples of these professions are accountants, lawyers and engineers.

Example 1

Nathan is a lawyer who is a member of the Malaysian Bar Council. He practises his profession through a legal firm, Nathan, Ali & Co. Nathan falls within the meaning of a professional under this PR.

- 5.2 However, there are some professions which require a person to be registered with a body corporate which governs the profession and is recognized by the Malaysian Government for purposes of practising and maintaining his profession. The person is not required to be a member of the relevant professional body. Examples of these professions are medical doctors, dentists and architects.

Example 2

Dr. Maira is a doctor who is registered with the Malaysian Medical Council (MMC) which is a body corporate incorporated under the Ministry of Health. She is not a member of the Malaysian Medical Association (MMA), the professional body which represents her profession. In the year 2017, she practises her profession as a doctor in her own clinic. Dr. Maira falls within the meaning of a professional under this PR.

6. Requirement to Purchase Professional Indemnity Insurance

- 6.1 A professional, due to the nature of his work, may be exposed to the likelihood of lawsuits for professional negligence for what he had done or what he had said in the course of carrying out his work.

Example 3

Voon, an accountant had given advice on a financial transaction to a client who subsequently lost his money after acting on that advice. The client may sue Voon for the money lost in the transaction and may claim compensation from him because he has given advice without due care.

- 6.2 Some professions require their members to purchase PII as provided under the profession's by-laws or rules. Examples of these professions are medical doctors, accountants and lawyers.
- 6.3 Whereas in other professions PII is generally purchased on grounds of prudence and not because it is a requirement under the profession's by-laws or rules. Examples of these professions are engineers and architects.

7. Tax Treatment on Professional Indemnity Insurance Premium

- 7.1 A practising professional is allowed a tax deduction for PII premium if the professional carries on a business related to his profession.

Example 4

Dr. Steven, a partner in a business of dental practice, operates from a clinic together with his partners. He is registered with the Malaysian Dental Council (MDC) and holds an Annual Practising Certificate. In the year 2017, he purchased a PII policy to cover himself in the event of lawsuits arising from the carrying on of his profession as a dentist.

The premium paid for PII qualifies as a deduction against his gross income from the partnership business since Dr. Steven carries on the business of his profession.

Example 5

Mr. Lee is a sole-proprietor of an engineering business, Excellent Engineering Consultancy. In the year 2017, he purchased a PII policy and paid a premium totalling RM10,000. He is a member of The Institution of Engineers Malaysia (IEM). The statute or by-laws of IEM does not require its members to purchase a PII policy in order to practise as a professional.

For the year of assessment 2017, the PII premium paid is allowable as a deduction against the gross income from his business because he carries on the business of his profession.

- 7.2 In the case of a professional who is not practising his profession but carries on other business or is in employment, the premium paid for PII is not allowed as a deduction against the gross income from that business or employment.

Example 6

Dr. Aidil is a full-time surgeon employed by a government hospital. He is registered with the MMC and is also a member of the MMA. In the year 2017, he purchased a PII policy and paid a premium of RM2,400.

The PII premium paid for the year 2017 is not eligible for deduction against Dr. Aidil's employment income because he is not carrying on a business related to his profession.

Example 7

Felicia is an accountant who does not practise as an accountant but instead is carrying on a full-time direct-selling business. Felicia purchases a PII policy to maintain her professional status as an accountant.

As Felicia is not carrying a business related to her profession as an accountant, she does not satisfy the requirement needed for deduction of PII premium. Thus, the PII premium paid is not allowed as a deduction from the gross income of the direct-selling business.

7.3 PII premium incurred by a company

Where a particular professional body allows its members to practise the profession in the form of a company and PII is purchased by the company, the PII premium paid by the company is allowed as a deduction against the gross income of the company if the company carries on a business related to that profession.

Example 8

Senibina Bumi Landskap Sdn Bhd (SBLSB) is a consulting architecture company which provides architectural consultancy and services. The company purchased a PII policy to cover the cost of compensation and defending lawsuits in relation to the construction project of a hotel in Putrajaya.

Since SBLSB which carries on an architectural business purchased a PII policy related to the architect profession, the PII premium paid is allowed as a deduction against the gross income of the company's business

7.4 PII premium for a locum

Where a professional carries out duty as a locum purchases PII, the PII premium paid is not allowed as a deduction from his income of his locum as a locum or any other income. For the purposes of this PR, "locum" means a person who temporarily fulfills the duty of another person carrying out the same profession. For example, a locum doctor may stand in for another doctor in a hospital or a clinic. Income from a locum is taxed as income from an employment.

Example 9

Dr. Merican who carries on a business as a doctor since the year 2015 purchased a PII policy to cover himself against lawsuits in the course of carrying out his profession as a doctor. He paid PII premium amounting to

RM2,500 each year since 2015. From January 2017, Dr. Merican also carries out duty as a locum in another private clinic and purchased an additional PII policy to provide protection for his duty as a locum doctor. The PII premium paid in respect of this PII policy is RM1,000 per year.

Dr. Merican is entitled to a deduction of the PII premium amounting to RM2,500 paid in relation to carrying on the business of his profession. However the PII premium amounting to RM1,000 paid in relation to his duty as a locum is not allowed a deduction against his income as a locum or the business income since it is not made in the course of carrying on a business related to his profession.

8. Tax Treatment on Insurance Proceeds and Compensation

8.1 Where a professional has been allowed a deduction for the PII premium paid, any proceeds received in connection with the PII will be subject to tax. The proceeds are taxed under subsection 22(2) of the ITA.

8.2 Compensation to a claimant can be made in the following manner –

- (i) the insurance company pays the proceeds to the professional and the professional pays that amount to the claimant; or
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The compensation paid in both of the above manner is allowed a deduction under subsection 33(1) of the ITA as it is incurred in the ordinary course of the business of a professional who is constantly exposed to the risk of being sued by his clients for negligence, error or breach of duty.

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Example 11

Same facts as in **Example 10** except that the insurance company made the compensation payment of RM200,000 directly to the claimant.

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Bernard, the sole-proprietor of a legal firm received proceeds amounting to RM200,000 from an insurance company and this amount could not cover the compensation of RM250,000 to be paid to a customer who had made a claim against him. Therefore, Bernard had to bear on his own RM50,000 to cover the shortfall of compensation payment to the claimant.

Proceeds amounting to RM200,000 will be subject to tax. When the proceeds are paid out as compensation to his client, the amount is allowed as a tax deduction. The compensation totalling RM50,000 incurred by Bernard is also allowable as a deduction from the gross income of his business.

9. Updates and Amendments

	Amendments	
This PR replaces the PR No. 3/2009 dated 30.07.2009 (current PR).	The contents of this PR have been ammended as follows :	
	Paragraph	Amendments
	4	The addition of 'Introduction'. Paragraph 4 of the current PR is amended to become Paragraph 5.
	6.2	This paragraph is from Paragraph 5.3 of the current PR. Paragraph 5.2 of the current PR is deleted.
	7.1	This paragraph is from Paragraph 6.3 of the current PR with part of the sentence in this paragraph deleted. Paragraphs 6.1 and 6.2 of the current PR are deleted because they are not applicable anymore.
8	This paragraph is from Paragraph 7 of the current PR with – (i) amendments to the sentence in Paragraph 7.2 of the current PR. (ii) Additional example 11, scenario where payment of compensation is made by the professional to the claimant. (iii) new Paragraph 8.3 and Example 11 in the current PR is amended to become Example 12.	

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**